Chevron

February 5, 1996

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MMS Proposed Rule
"Amendments to Gas Valuation Regulations for Federal Leases"
60 FR 56007 (November 6, 1995)

Dear Sir:

Please find attached the comments of Chevron U.S.A. Production Company on the subject proposed rule.

Chevron appreciates the opportunity to comment on the proposed rule.

Sincerely,

George W. Butler

Attachment

COMMENTS OF
CHEVRON U.S.A. PRODUCTION COMPANY
MINERALS MANAGEMENT SERVICE PROPOSED RULE
"AMENDMENTS TO GAS VALUATION REGULATIONS FOR FEDERAL LEASES"
30 CFR 202, 206, and 211
60 FR 56007 (November 6, 1995)

Chevron U.S.A. Production Company, a Division of Chevron U.S.A. Inc. ("Chevron"), one of the largest payors and reporters of royalty on gas production from federal leases, offers these comments on the Minerals Management Service's (MMS) November 6, 1995 notice of proposed rulemaking.

Chevron endorses and adopts in full the oral comments made by George W. Butler in the January 22, 1996, public hearing held in Houston, Texas. Chevron also endorses and adopts in full the separate comments of the American Petroleum Institute (API), the Rocky Mountain Oil and Gas Association (RMOGA), and the Council of Petroleum Accountants Societies (COPAS).

Chevron strongly endorses the consensus of the Federal Gas Valuation Negotiated Rulemaking Committee ("Committee") and the recommendations appearing in the March 1995, *Final Report, Federal Gas Valuation Negotiated Rulemaking Committee* ("Final Report"). Chevron commends all of the members of the Committee for reaching consensus on very important valuation issues. If the consensus of the Committee is adopted in a final rule, Chevron believes that greater certainty will be achieved, and unwanted litigation will be avoided. Chevron urges MMS to faithfully reflect the consensus of the Committee in the final rule, and to reconvene the Committee in the event a final rule inconsistent with the Committee's consensus is contemplated.

Chevron's remaining comments are directed toward: (1) instances where proposed rule fails to reflect the consensus of the Committee, and (2) specific requests for comment made by MMS in the proposed rule.

1. **Incorporation of Committee consensus into exiting regulations.**

At 60 FR 56008, MMS states: "The rulemaking process has necessarily required that the Committee's consensus be incorporated into the existing regulations." It was not the consensus of the Committee to do so. Neither Chevron's endorsement of the Committee's consensus, nor its comments on the proposed rule, are intended as, or should be interpreted to be, an endorsement of, or comments upon, any existing regulations.

2. **100% Federal Agreements and Stand-Alone Leases**

The preamble, at 60 FR 56015, fails to set forth in detail the MMS draft proposal on payment and reporting for agreements which contain only Federal leases with the same royalty rate and funds distribution.

While it is true that the Committee concurred with the MMS draft proposal, API's representative expressly stated that API's members did not agree that a lessee should be liable for royalties on production in excess of its entitled share of production. API also stated that, in the event that MMS' regulations established different payment and reporting requirements for 100% federal agreements and mixed agreements, lessees needed clear guidance on which agreements fell into each category, plus an adequate period within which to adjust reporting in the event a 100% federal agreement changed into a mixed agreement.

Unfortunately, neither this proposed rule, nor the June 9, 1995 proposed rule at 60 FR 30492 contain any mention of a grace period during which a lessee would be allowed to adjust

from takes to entitlements in the event a 100% federal agreement were changed into a mixed agreement, or vice versa. MMS must recognize, in this proposed rule and in the June 9, 1995 proposed rule, that establishing different royalty payment and reporting requirements for 100% federal agreements and mixed agreements also necessitates addressing situations when an agreement changes from one type to the other.

More importantly, neither this proposed rule, nor the June 9, 1995 proposed rule, fully reflect the draft proposed rule submitted by MMS to the Committee for its concurrence. The MMS proposal, entitled "MMS Proposed Rule on Takes," was very detailed and was 8 pages in length. A copy is attached hereto as Exhibit "A."

Notwithstanding the detailed proposal presented to the Committee, the preamble merely states: "The Committee concurred with an MMS draft proposal that payment should be made on a takes basis with an exception to seek approval for payment on an entitlements basis. Because this subject was beyond the Committee's charge, MMS included it in that separate rulemaking (60 FR 30492, June 9, 1995)." The June 9, 1995 rule provides only: "...if you are an operating rights owner who takes production allocated to a lease in an agreement under this paragraph, you must report and pay royalties on the production you take. You must: (i) File a PIF with MMS as specified in Part 210 of this title and the MMS Payor Handbooks: (ii) Report the royalties owed for that production on a Form MMS-2014. You must use one or more of your MMS-assigned lease accounting identification numbers (AID). Also, you must follow the instructions provided in Part 210 of this title and the MMS Payor Handbooks; and (iii) Pay royalties on that production as specified in Part 218 of this title and the MMS Payor

Handbooks." This language simply fails to mention numerous details set forth in the draft rule prepared by MMS and submitted to the Committee for its concurrence.

Chevron encourages MMS to propose a rule which reflects the draft proposed rule submitted to the Committee.

3. **Royalty on Gas Contract Settlements**

The proposed rule, at 206.454(a)(6), would require a lessee who receives revenue pursuant to a gas contract settlement entered into prior to the effective date of the rule to pay royalty on such revenue in addition to any index-based payment. MMS states, at 60 FR 56011: "Paragraph (a)(6) of 206.454 would address an issue that the Committee did not consider. It involves situations where a lessee entered into a gas contract settlement prior to the effective date of the final rule in this matter, and actually receives the settlement payment before or after the effective date of the final rule....Paragraph (a)(6) of 206.454, as proposed, does not require that royalty be paid on any amounts attributable to gas contract settlements entered into after the effective date of this rule where the lessee uses an index-based or other value under 206.454...MMS specifically requests comment on whether amounts for gas contract settlements entered into after the rule's effective date should be subject to royalty for lessees who use index-based or other values under 206.454."

Chevron disagrees that this was an issue which the Committee failed to consider. Many hours were spent discussing why it was necessary to develop an alternative which would alleviate the burden of allocating gross proceeds and allowable deductions to individual leases. Consensus was reached that a lessee should be allowed to value production based on index prices and should be required to pay additional royalty only if its average index payments for a zone are less than the final safety net median value for that zone. Yet Paragraph (a)(6) would

require index payors to allocate proceeds from gas contract settlements to individual leases and make payments each month over and above any index payments and required true up payments. This is inconsistent with the consensus reached by the Committee. Chevron encourages MMS to delete Paragraph (a)(6) from the final rule.

4. Failure to publish a final safety net median value within 2 years.

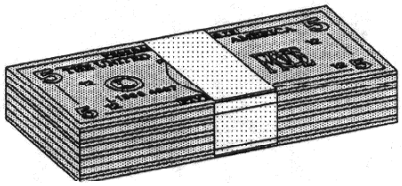
At 60 FR 56012, MMS states: "The Committee did not address the consequences of MMS not publishing the final safety net median value within two years. MMS requests comments on the appropriate consequences in this event."

Chevron disagrees that this is an issue which the Committee did not address. The Committee spent hours debating the time period for publishing the final safety net median value. The final consensus of the Committee was that alternative royalty value for qualified zones would be index plus any required true up to a safety net median value published within 2 years. There was never any doubt as to whether additional royalty would be due if the safety net median value were not published in 2 years. Clearly, in the absence of such value being timely published, no true up payment is required. To require otherwise would be inconsistent with the Committee's consensus.

Submitted on Monday, February 05, 1996

MMS PROPOSED RULE ON

TAKES



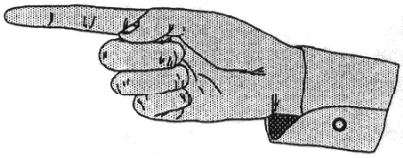


EXHIBIT "A"

SCOPE

- Agreements with only Federal leases with same royalty rate and funds distribution

  19% of all agreements (634 PA's and 1592 CA's)

  73% of 231 offshore PA's

  12% of AID's

  14% of revenues

- All Federal leases not in agreements (stand alone)

  35% of AID's
  50% - 65% of revenues

Total

47% of all AID's

65% - 80% of all revenues

REQUIREMENTS

Valuation

- The actual disposition of production controls valuation

AL: Value based on taking parties' gross proceeds

NAL: Value based on NAL criteria applied to taking parties' disposition

REQUIREMENTS

Reporting and Payment

- Working Interest Owners report and pay on what they take
- WIO's use only their own AID's for reporting

Single AID reporting:

- Report under only one AID for lease or agreement
- Exception transportation and processing allowances reported separately

Considerations:

- Minimum royalty
- Systems changes

ALTERNATIVES

Differing Funds Distribution

- Offshore 8(g) leases
- Onshore overlying county boundaries

Exceptions

- MMS approves other methods (i.e., entitlements) on a case-by-case basis

Offshore agreements only

- Modify only valuation policy

Entitlements

- Valuation still under takes (or tracing)

Consistent with other agreements

- Establish same polcy for all types of agreements

DRAFT OUTLINE OF PROPOSED TAKES RULE

Scope of Rule

Product codes: 03, 04, 07

Leases: (1) Leases in offshore and onshore agreements with 100 percent Federal lands, and (2) stand-alone leases.

Excluded leases: Indian leases and leases in agreements containing a mix of land ownership and/or royalty rates. These are the subject of a concurrent effort.

- Offshore agreements (168 out of 231):

  (a) 100 percent Federal lands

  (b) same royalty rate

  (c) same fund code

  We will request comments on including agreements with differing fund codes whereby MMS would allocate royalty distributions.

- Onshore agreements: same (a) through (c) criteria for offshore, but also

  (d) agreement contained completely within one county

  We will request comments on including agreements overlying county boundaries, whereby States would be responsible for their own allocation, or MMS could perform allocation.

Percentage of revenues affected (for each product code):

03: 78% 04: 76% 07: 67%

Estimated percentage of reported AID's affected (for all products):

35% [stand-alone leases] + (.19 * 65% [agreement leases]) = 47%

Proposed Rule Requirements

Paying and Reporting Requirements:

- Those working interest owners who take and sell Federal production must report and pay royalties on that production.

- To reduce reporting lines for agreement production, payors will be assigned a unique, single AID number for reporting all of their sales of agreement production.

  - transportation and processing allowances must also be reported under the single AID. However, to report allowances exceeding the limitation, a separate AID must be used.

  - an exception will be granted to those parties wishing to report takes under more than a single AID.

  We will request comments on making single AID reporting a requirement or an exception.

- Taking parties will be held responsible for any underpayments of royalties or allowances associated with the volume of production they took.

- Taking parties must submit a standard PIF establishing them as a responsible payor. A PIF, coupled with this rulemaking, should provide adequate legal grounds (i.e., supported in court) for *basic* payment responsibility.

  - any transfer of this responsibility will be handled/addressed by payor liability team/rulemaking.

  - ultimate liability in cases of default, bankruptcies, etc. will still probably fall on the lessee of record title, or bond holder.

Valuation Requirements:

- The actual disposition of production will control valuation.

- Arm's-length sales: The gross proceeds received by the taking party will generally determine value.

- Non-arm's-length sales: MMS's non-arm's-length valuation criteria will apply to the non-arm's-length disposition.

Exceptions:

- Lessees may request MMS approval of other methods of payment for these leases (i.e., entitlements). However, a valuation proposal must accompany the request.

STATISTICAL INFORMATION REGARDING FEDERAL AND INDIAN UNITIZATION AND COMMUNITIZATION AGREEMENTS

AGREEMENTS CONTAINING 100 PERCENT FEDERAL LANDS

	Participating Areas	Comm Agreements	Totals
Total active agreements	2,386	9,135	11,521
100 percent Federal lands	874	2,374	3,248
100 percent Indian lands	12	202	214
100 percent Federal/one fund	809	2,139	2,948
100 percent Federal/same royalty rate	645	1,668	2,313
100 percent Federal/one fund /same royalty rate	634	1,592	2,226*

*19 percent of all PA's and CA's contain 100 percent Federal lands with the one fund code and the same royalty rate.

NUMBER OF PAYORS FOR 100 PERCENT FEDERAL AGREEMENTS

Product Code	Number of Payors	Number of Agreements	Percent of Agreements
01	1	768	76%
	2	184	18%
	3	31	3%
	4 or more	31	3%
02	1	870	76%
	2	212	18%
	3	47	4%
	4 or more	22	2%
03	1	813	82%
	2	138	14%
	3	26	3%
	4 or more	18	2%
04	1	1,623	67%
	2	540	22%
	3	155	6%
	4 or more	101	4%